Arizona Department of Financial Institutions

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Mission Statement

Our mission is to regulate and supervise the financial institutions and enterprises of Arizona according to statutes in ways that will not unreasonably impede economic growth or business activity and provide consumer support to the greatest possible extent.

Superintendent's Corner: "RAISING THE BAR" IS EVERYONE'S RESPONSIBILITY

Superintendent Rotellini

I am grateful to the foresight of Senator Jay Tibshraeny for sponsoring and getting legislation passed that creates a separate crime of "mortgage fraud." HB2040 was signed by Governor Janet Napolitano on June 13, 2007. The legislation will be effective in mid-September. The legislation was supported by all professions that participate in Arizona's real estate industry. The successful enactment of HB2040 is an example of Arizona lawmakers, regulators, and industry leaders striving to make the mortgage and real estate industry accountable so that consumers and compliant licensees have confidence in their state government, the real estate market, and Arizona's economy.

The Arizona Department of Financial Institutions (DFI) will continue to examine, investigate, and take administrative action against the mortgage and escrow licensees that flagrantly violate the statutes and engage in mortgage fraud. Our investigators are working with several state and federal civil and law enforcement agencies on pending investigations. As these cases develop, we will refer them to our law enforcement compatriots for prosecution.

I applaud the Arizona Association of Mortgage Brokers (AAMB) for sponsoring loan officer licensing legislation (HB2320) during the 2007 Legislature and the Arizona Mortgage Lenders Associations (AMLA) for their support. Loan officer licensing will screen out persons of poor character and incompetence and will ensure that loan officers are educated and held accountable. I have yet to meet a real estate professional, appraiser, title and escrow agent or consumer who does not support loan officer licensing.

It was my hope that by the time this newsletter was published, Arizona would have a law in place that uniformly regulated loan officers in the mortgage industry. Unfortunately that is not the case. I support the efforts of AMLA and AAMB to improve their profession and to get such legislation enacted in 2008. In the meantime, I continue to applaud the professions' work to raise the level of awareness and adoption of best practices in the industry.

Continued on next page

Learn more about Superintendent Rotellini by visiting www.azdfi.gov and click on "Superintendent."

Superintendent's Corner continued…

As of the date of this publication, there are 603 licensed mortgage bankers in Arizona with 2,488 branches. There are 1,501 mortgage broker licensees operating 807 branches. By the time this newsletter is circulated, these numbers will have increased. In spite of the softening of the real estate market in Arizona, we have not experienced a slowdown in the number of mortgage broker or banker license applicants. A record 109 people took the mortgage broker examination in February 2007. 108 people sat for the test in April of 2007.

There is a lot of loan origination going on in Arizona. The majority of the licensed mortgage bankers are not national firms. Many of these licensed bankers broker their loans. In Arizona, there are three types of licensed residential mortgage companies: brokers, bankers, and the hybrid mortgage bankers that fund and broker mortgage loans. Loan officer licensing should apply to all licensees brokering loans, whether they are a broker or a banker.

Some critics of loan officer licensing question why licensed mortgage companies should be subjected to a law to improve the professionalism and qualifications of their loan officers. Why should government do what businesses should be doing on their own?

I agree that any reputable mortgage company wants to serve its clients, make a profit, and foster the good will necessary to stay in business. To accomplish those goals, it makes sense to ensure that loan officers have a minimum level of competence and good character. Two of the most publicized issues, predatory lending and mortgage fraud, are blamed on "bad" loan officers.

AMLA and AAMB promote ethical and responsible business practices and are part of the solution to the many problems plaguing the industry today. Unfortunately, there are more than 2,100 licensed mortgage brokers and bankers in this state, employing between 10,000 and 18,000 loan originators, and only a fraction are members of AMLA and AAMB. The net branching phenomenon and companies willing to give up internal controls for growth have fostered a "profits at all costs mentality," which volunteer professional associations cannot stop. Best practices are not being implemented at the necessary level.

Another criticism of loan officer licensing is that government should stay out of business and let the market dictate best practices and who survives in such a highly competitive business. This is another valid point. The recent fall out in the sub-prime mortgage industry lends credence to this theory. While the market may take care of the companies, what about the displaced families and inflated home values that hurt all homeowners and communities? Arizona has jumped from 19th in 2005 to 5th in 2006 for mortgage fraud involving sub-prime loans. *(MARI's Ninth Periodic Case Report to the Mortgage Bankers Association, April 2007)*.

Since the January 21, 2007 *Arizona Republic* article on mortgage fraud, DFI has been buried with anonymous tips, phone calls, e-mails, and formal complaints about real estate and mortgage fraud. When I attended the AMLA fraud seminar on January 24, appraisers brought me spreadsheets and copies of e-mails evidencing cash back schemes and loan officers soliciting appraisers for a certain value. It is the "dirty little secret" that is neither little nor a secret in the real estate community—and it must be addressed.

Arizona licensed mortgage brokers and bankers would benefit from a loan officer licensing requirement. Both industries must come together to improve the quality of the mortgage business in Arizona. Raising the bar should never be considered an obstruction or barrier to profits. Rather, loan officer licensing is the way to gain greater consumer confidence and to provide the best service to customers who are about to engage in the most important and costliest investment of their lives.

ATTENTION: NEW FORMS

MORTGAGE BANKERS, MORTGAGE BROKERS, AND COMMERCIAL MORTGAGE BANKERS

Effective July 1, 2007, DFI will begin using new forms for all license renewals and new license applications. Please carefully read and answer all questions.

These forms will be available at www.azdfi.gov. Click on the "licensing" button, then "download application package" or "download renewal package."

DFI
newsletter

Licensing News

Richard Fergus, Division Manager,
Licensing and Consumer Affairs

Mandatory Reporting Rule

Existing labor laws, A.R.S. § 23-1361, provide civil immunity for communications between banks, credit unions, escrow agents, mortgage brokers, mortgage bankers, and commercial mortgage bankers about dishonest employees. The statute deems such communications, concerning employees or prospective employees, privileged when the information exchanged between companies is reported to DFI "pursuant to written rules or policies." (A.R.S. § 23-1361(E)).

DFI is proposing a mandatory reporting rule that will trigger the protections of A.R.S. § 23-1361. The rule will require these entities to report information about former errant terminated employees whose conduct warranting termination falls under any of the categories of A.R.S. § 6-161, which authorizes the Superintendent to remove dishonest and unfit employees. The rule will provide civil immunity to and allow employers to help DFI eliminate unfit and dishonest employees from these licensed and chartered financial entities.

DFI will post the text of the proposed new rules on www.azdfi.gov as soon as a Notice of Proposed Rulemaking is available.

DFI sought and received very helpful feedback and suggestions during the drafting of the rule. For a full discussion of the objectives behind the proposed rule, access our website and click the "rules" tab. If you have any questions or comments, please contact Jack Hudock, DFI's rules attorney at 602-255-4421, ext. 167.

Renewals

<u>Reminder:</u> All licensees must renew their licenses annually. You must submit the applicable renewal fees and renewal application by the due date. Failure to do so will result in your license being closed for non-renewal. All licensees should review the applicable statutes for renewal dates and fees.

Corresponding with DFI Licensing and Consumer Affairs

To assist in the processing of applications and any other licensing matters, it is important that you include the 7-digit license number located on the primary license (i.e., BK 1234567). When responding to a written request from the licensing division, please include a copy of DFI's letter requesting the documentation with your response. By including your license number and a copy of any correspondence, you will assist DFI in ensuring that your requests are sent to the correct customer service representative for processing.

When corresponding about consumer complaints, please include the complaint number referenced in the initial correspondence from DFI. As of June 12, 2007, DFI has 840 active complaints processed by five consumer affairs examiners. By including the complaint number, you will ensure that your information is sent to the correct consumer affairs examiner.

It is important that you timely respond to any complaint or request for information. Failure to respond timely is a violation of the statutes and may result in the imposition of a civil money penalty of up to $5,000.00 per day per violation.

Deferred Presentment Companies

The Phoenix City Council passed a city ordinance limiting the distance between payday lender locations. DFI is working with the City of Phoenix to ensure that all new payday lenders and any new branch location located in the city of Phoenix are in compliance with the new ordinance. In order to ensure compliance, DFI now requires all applicants and licensees to complete and submit a Phoenix Zoning Clearance form with all new license and branch applications and change of address requests. This is only required for those locations physically located within the city of Phoenix.

The form must be completed and approved by the Phoenix Planning Department before a license will be issued. You can contact the City of Phoenix Planning Department at (602) 262-7131 or visit their office at 200 W. Washington Street, Phoenix, Arizona 85003. The Phoenix Zoning Clearance form is also included in our application package and branch application package. Applications may be downloaded from our website at www.azdfi.gov.

Licensing

DFI has six customer service representatives handling all licensing matters. Some of the issues handled by DFI's customer service representatives include: (1) Administering the mortgage broker test (with over 100 test takers at each test); *Continued on next page*

Mortgage Brokers, Mortgage Bankers, Commercial Mortgage Bankers, and Collection Agencies must understand the applicable statutes and rules relating to responsible individuals and active managers. These are the statutes and rules: A.R.S. § 6-903(F); A.R.S. § 6-943(G); A.R.S. § 6-976(B); A.R.S. § 32-1023(C); A.A.C. R20-4-107; and A.A.C. R20-4-102.

Continued . . . (2) Processing new license applications (currently 281 in process with approximately 64 new applications a month); (3) Processing branch applications and address changes (approximately 185 per month); (4) Handling all other incoming mail (approximately 800 pieces of mail per month); (5) Answering telephone calls (approximately 1,700 per month); and (6) Processing annual renewals for all active licensees.

As of June 12, 2007, DFI has the following active licenses indicated as follows: (licensees), (branches):

Advanced Fee Loan Brokers: (3), (0); Banks: (31), (55); Collection Agencies: (587), (24) Commercial Mortgage Bankers: (13), (5); Consumer Lenders: (23), (111); Credit Unions: (27), (116); Debt Management Companies: (34), (14); Deferred Presentment Companies: (100), (730); Escrow Agencies: (117), (684); Money Transmitters: (62), (284); Mortgage Bankers: (604), (2,491); Mortgage Brokers: (1,501), (807); Motor Vehicle Dealers: (668), (197); Premium Finance Companies: (46), (8); Sales Finance Companies: (467), (280); and Trust Companies: (5), (1).

Total: licensees: 4,272 branches: 5,806

Credit Union News

Sue Meyer, Manager,
Credit Union Division

Member Business Lending

There has been some confusion throughout the industry concerning DFI's position on member business lending. The following outlines our expectations to eliminate any ongoing misunderstanding.

DFI believes credit unions can assist their members, increase deposits, and diversify their loan portfolios by offering various business services. A well-planned approach first focuses on establishing comprehensive policies and procedures; educating management and the Board of Directors; attracting business deposits; and then fulfilling business loan needs.

Although approached by the industry to promulgate a Member Business Loan ("MBL") rule, DFI opted to continue to require credit unions to comply with National Credit Union Administration ("NCUA") Rules and Regulations Part 723. Part 723.4(a) requires that loan officers underwriting MBLs must have a minimum of two years experience underwriting the specific types of business loans the credit union offers. For example, if the credit union offers working capital lines of credit or construction loans, the loan officer must have had at least two years experience underwriting both types of loans.

In lieu of the required experience, Part 723.4(a) also allows credit unions to contract with a third party vendor to underwrite MBLs. Though not specifically required by the regulation, when contracting with an outside party, DFI, NCUA, and many third party vendors advocate the necessity of having someone in-house with at least basic experience in commercial lending or financial analysis that can recognize the feasibility of the loan request and recommend the loan product that best fits the members' needs. *Continued on next page*

Banking News

Tom Wood, Manager,
Banking Division

As of year-end 2006, DFI has 34 state-chartered banks under supervision with total assets of $6.1 billion. We have lost two of these banks to mergers during the first half of 2007. However, we have in process seven applications for new banks in various stages of completion. Approximately half of these expect to open during the second half of 2007.

FINAL CRE GUIDANCE

All bankers are undoubtedly aware that the FDIC, Federal Reserve, and the OCC have recently issued their final commercial real estate ("CRE") guidance. The agencies clarified the purpose of the guidance by emphasizing that it is not intended to limit banks' CRE lending, but rather guide banks in developing risk . . . *Continued on next page*

IMPORTANT NOTICE:

Pursuant to A.R.S. § 6-161(E), a financial institution or enterprise may not employ the person against whom a final removal, suspension, or prohibition order has been issued without the Superintendent's prior written approval.

"Final Orders" are posted on DFI's website located at www.azdfi.gov

"Resources at your Fingertips"

www.azdfi.gov provides a wealth of information. Please use it to locate applicable statutes, rules, licensed entities, regulatory alerts, final administrative orders, and much, much more.

DFI Outreach

DFI is staying "connected" by presenting and informing licensees about: examination procedures, mortgage lending issues, regulatory enforcement actions, licensing, and consumer affairs complaints, to name a few.

Visit www.azdfi.gov and click on **"DFI Outreach"** for more information.

Credit Union MBLs continued

In the past, a few credit unions contracted with a third party vendor without having someone in-house familiar with this type of lending. As a result of numerous deficiencies in the loan files reviewed, DFI took action to prohibit or limit certain MBL programs. This was not necessarily an indictment of the capabilities of the third party vendor (although some underwriting deficiencies were identified), but more so a case of the credit union's unfamiliarity with commercial lending. Because the lending decision resides with the credit union, it is imperative that there is someone in-house that can review the loan underwriting and documentation to ensure the loan is in proper order. Depending on the content of the vendor contract, the credit union may be required to service the MBL by monitoring financial statements, performing cash flow analyses, disbursing funds, etc. In addition, the credit union may have to collect on a nonperforming loan, which requires different techniques than collecting consumer loans.

DFI has not prohibited any credit unions from using the services of a third party vendor. However, our expectation is that there is someone in-house that can identify and manage the potential risk in these types of loans. Credit unions cannot relinquish their responsibility by allowing a third party to make a loan decision carte blanche. Our philosophy is to ensure that the inherent risk in an MBL portfolio is monitored and controlled. We hope our credit unions share the same philosophy.

Banks' CRE Guidance continued

management practices and levels of capital that are commensurate with the level and nature of your CRE concentrations. The guidance focuses on CRE loans that are dependent on the cash flow, including rental income, from real estate held as collateral and sensitive to CRE market conditions, and does not apply to owner-occupied real estate where the primary source of repayment is cash flow from operations the owner conducts on the property.

Additionally, the agencies added to the 300% of capital threshold a check to determine if CRE loans have increased 50% or more during the prior 36 months. Examiners will use the thresholds as a starting point for identifying institutions that are potentially exposed to significant CRE concentration risk.

DFI urges all bankers to become familiar with the final guidance and manage the risks appropriately. State examiners will also follow this guidance during our independent examinations of your institutions.

HOME MORTGAGE DISCLOSURE ACT REPORTING

The Federal Reserve Bank of San Francisco informed DFI that state-chartered Arizona banks scored well in the latest HMDA review. The Fed reports no evidence of discrimination noted by reporting banks. This is very good news for Arizona consumers. DFI would like to thank the reporting banks for a job well done.

Financial Enterprises News

Robert Charlton, Assistant Superintendent, *Financial Enterprises*
Contributing Writer, Clyde Granderson, CFE

Mortgage Fraud News...

The *Arizona Republic* newspaper published a number of articles in 2007 regarding mortgage fraud. As a result, DFI was inundated with complaints and tips from both victims and honorable citizens who are fed up with mortgage fraud schemes that have affected our communities.

One of the most prevalent fraud schemes involves inflating home values and providing extra cash-back to the perpetrators. The fraud includes obtaining mortgages for much more than the home is worth and pocketing the extra money in cash for as much as $100,000 per sale. These sales affect neighborhood home values by temporarily showing higher prices, but the downside appears a few months later as these properties are sold in foreclosure sales at much lower prices. We now have sections of neighborhoods all over the valley that have been negatively impacted by these cash-back scams.

One of the most common indicators of the cash-back scam is a property that has sat on the market for three or more months, for say, $290,000 and then suddenly sells for $350,000. Our investigations show that, generally, for the cash-back scams to occur, the following participants are needed:

- Willing Seller
- Realtors
- Appraiser
- Investor, Buyer, or Straw-Buyer
- Loan Officer
- Escrow Officer

In January 2007, Senator Jay Tibshraeny introduced a bill that would make residential mortgage fraud a felony. On June 13, 2007, Governor Janet Napolitano signed the legislation making residential mortgage fraud a class 2 or 4 felony, depending on the number of residential properties involved (See A.R.S. § 13-2320). Please be aware of potential mortgage fraud schemes. Contact DFI at www.azdfi.gov with any questions.

AZDFI
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Asian Bank of Arizona Grand Opening!

On June 16, 2006, Asian Bank of Arizona had its Grand Opening celebration! The bank is located at 668 N. 44th Street in Phoenix. Congratulations on your one-year anniversary.

Left to Right: Keith Wong, Felecia Rotellini, Bruce Tunell, John Yee, and Gary Ong